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¶1. (SBU) SUMMARY. Below please find post responses to reftel questions on expected priorities and objectives for the European Union (particularly European Commission) at the November 15 G20 Summit. French President Nicolas Sarkozy, in his role as President of the Council of the European Union, and Jose Manuel Barroso, President of the European Commission, will both represent the European Union at the Summit. Post will follow with more detailed reporting on EU priorities for the Summit, to be reported septel. END SUMMARY.

Begin responses to questions:

¶I. Key Objectives and Priorities/Desired Outcomes of the Summit

The French Presidency proposes a massive overhaul of international financial architecture. President Barroso will seek to curtail France's more extreme proposals, but he supports discussions at the Summit on a framework of stronger regulation for the global financial system and "addressing global imbalances," while avoiding protectionism. The Commission also seeks an EU seat at international financial institutions and will use the crisis to boost its role.

II. Key Concerns

The lack of effective regulatory coordination of European banks is a key concern for the Commission. While the U.S. should not get in middle of Commission-Member State disagreements over prerogatives, the Commission can be a useful ally to restrain more interventionist and anti-market Member States such as France. Financial stability is the primary goal, but the Commission is also concerned with minimizing distorting effects on competition of financial market interventions and is conducting reviews of interventions for compliance with EU State Aid rules.

III. Impact of Financial Market Crisis on the Financial Sector

The financial sector in the European Union has lost about $183 billion due to the crisis to date, and numerous banks have failed or been bailed out. So far, the crisis has had only a marginal effect on lending to the private sector. Lending to households was slowing before the crisis began, while lending to corporates started decelerating in March of this year and remains at a healthy 12.6 percent (year/year) annual growth rate. The strong negative effect on consumer and investor confidence is the real story.

IV. Actions Taken to Address the Financial Crisis

The EU recognizes that while its bank regulation is still done on a national basis, bank operations and their problems are extending across borders, and this inconsistency must be addressed via improved and consolidated supervision. Member states have conducted financial sector interventions exceeding 1.8 trillion euros. The EU has raised minimum deposit insurance to 50,000 euros immediately and 100,000 euros within a year. The ECB has dramatically increased lending to EU banks, implemented full allotment auctions at a fixed rate, expanded its USD swap arrangement with the Fed, and lowered collateral requirements to allow more securities to be pledged for ECB credit by banks. The Commission has proposed revisions to the Capital Requirements Directive, setting new minimum prudential ratios for EU

banks and calling for originators to keep a portion of securitized assets on their balance sheets, and will propose (possibly November 5) greater regulation of credit rating agencies. The Commission will issue a plan November 26 to boost EU economic growth, including a doubling of the EU's crisis fund, capital increases for the EIB, accelerating investment in key sectors such as green technology, clean cars and infrastructure, and possible soft loans to the automotive sector.

¶V. Current Economic Situation/Near-Term Outlook

Economic growth in the EU is projected to be zero in the third and fourth quarters of 2008, and expected growth for 2008 has been reduced to 1.4 percent from 2.0 percent in earlier forecasts. Germany, Spain, the UK, Ireland, and Denmark entered recessions in the second half of 2008. An economic recovery for the region is not expected until ¶2010.

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